

SAVANNA ENERGY SERVICES CORP. 2005 ANNUAL REPORT



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President's Message

2005 represented another record year for Western Canadian drilling activity, and another record year for all of Savanna's operating divisions. In virtually every category of performance, across all of our divisions, Savanna achieved record results.

Our drilling division drilled a record 3,269 wells in 2005, despite being hampered by wet weather in our core operating areas. We again, were the third most productive driller in terms of wells and meters drilled, and first in terms of wells and meters drilled on a per rig basis.

We were successful in gaining a full year's operating experience with our deeper CT2200 platform. Savanna provided numerous customers access to the rig, and applied our technology to various drilling situations, including drilling to depths of up to 2500 meters. We are very pleased to report that virtually all testing of the rig to date was both operationally and economically positive.

Based on results to date, the CT2200 platform generates meaningful savings to our customers, and the breadth of potential application of the platform is extremely promising. Savanna will put an additional seven CT2200 rigs to work in 2006 to further test the market breadth and capability of the platform. Indications are that we will continue to aggressively expand both the CT1500 and CT2200 platforms. Our recent entry into the conventional drilling market at depths not technically or economically conducive to hybrid drilling also opens a new potential growth market for this division.

Savanna's wireline business expanded by five units during 2005, but equally importantly increased revenue per truck, new and existing, by over 30%. We are continuing to expand our training programs in all of our divisions, and are moving closer to creating our own source of qualified operators in the wireline division specifically. It is our objective to reach a level of self-supply of qualified operators within the next 2-3 years, which will allow a more aggressive capital build program moving forward.

Our well servicing division attained its highest ever utilization rates throughout 2005. Record hourly rates were also achieved during the year, resulting in this division achieving record per rig revenue and profitability levels. With four new rigs under construction for 2006, we anticipate continued strong growth in this division as well.

As we are preparing this message, oil prices are hovering in the mid \$60's (U.S.) and natural gas prices at around \$7.00 (U.S.). Natural gas storage is at record levels due to the warm winter, and there is concern regarding activity levels amongst our customers at these price levels. While we are certainly aware of these pressures, to date we have received no indications from any of our customers that they intend to reduce their demand for our services. In fact, in January we signed long term contracts (in excess of 2.5 years on average) for 24 of the rigs (75%) in our fleet. The remainder of our fleet is fully committed through 2006. We remain confident regarding the fundamentals for our sector moving forward.

Such is our confidence in the sector overall, and our product and service offerings in particular, that we have embarked in 2006 on our largest capital expansion program ever. We have committed to expend over \$90 million on equipment and facilities, including twelve drilling rigs, four service rigs and two wireline units. Our employee base has grown from four in 2001 to just under 1,000 today. Despite our tremendous growth in capital assets, it is the dedication and effort of those individuals that will extend Savanna's success in the future.

On behalf of management and the Board of Directors.

A handwritten signature in black ink, appearing to read 'Ken Mullen', with a stylized, looping flourish at the end.

Ken Mullen
President & CEO
March 9, 2006

Management Discussion and Analysis

Savanna is an oilfield services company operating in Western Canada. Our overall business is conducted through three major segments:

- 1) Contract drilling;
- 2) Well servicing; and
- 3) Cased hole wireline services.

Discussion of market trends and operations for the last two years is included below. This discussion should be read in conjunction with our consolidated financial statements and notes thereto. Our discussion includes various forward-looking statements about our markets, demand for our products and services and our future results. The statements are forward-looking statements in the context of Canadian and U.S. Securities Regulations. These forward-looking statements are not historical facts, but instead are based upon our analysis of currently available competitive, financial and economic data and our operating plans. They are inherently uncertain and investors must recognize that events and actual results could turn out to be significantly different from our expectations. Important factors, among others, that could cause our results to differ, possibly materially, from those indicated in the forward-looking statements are discussed below.

As used in this report, "we", "us", "our" and "Savanna" means Savanna Energy Services Corp. and, where the context requires, includes our subsidiaries, Trailblazer Drilling Corp. ("Trailblazer"), Great Plains Well Servicing Corp. ("Great Plains") and Ultraline Services Corporation ("Ultraline").

Market Trends

To a substantial degree, Savanna's businesses depend on the level of spending by oil and gas companies for exploration, development and production activities. Sustained increases or decreases in the price of natural gas or oil could have a material impact on exploration, development and production activities, and could also materially affect our financial position, results of operations and cash flows.

Historically, the oil and gas industry has been subject to volatility because of significant changes in the demand for, supply, and pricing of natural gas and oil. The primary contributing factors associated with these price increases include the convergence of supply and demand for natural gas and oil brought about by secular global economic growth and the increasing difficulty, expense, and lead times involved in adding to domestic North American supplies. The factors that sustained the increase in the prices of natural gas and oil starting in late 2002 carried on through 2005, and resulted in historically high drilling and completion activity throughout the Canadian basin.

Heading into 2006, prices for oil and gas remained at high levels. They have since come under pressure as a result of a warmer-than-anticipated winter. Storage levels of both products are at five year highs, and there is concern that pricing could remain soft for the next several months at least. While these price decreases have not as yet caused any of our customers to reduce their 2006 plans in any meaningful way, this also poses a risk. It is our expectation that demand and pricing for our services will not be adversely affected by the current pricing environment, particularly when the demand-supply balance is considered. In the event activity is reduced for some limited period, Savanna is confident that the nature of our equipment/service offering will significantly soften its effect on us. Additionally, it is also our firm belief that the tight balance between supply and demand for energy, particularly natural gas, will result in activity levels recovering shortly thereafter.

2005 Compared to 2004

Selected Annual Information

(000's except per share data)	2005	2004
Revenue	191,614	129,013
Net Earnings	31,727	20,245
per share	1.10	0.73
per share diluted	1.08	0.71
Total Assets	277,329	205,202
Long Term Financial Obligations	43,212	38,191

Sales and Services Revenue

Revenue for 2005 totaled \$192 Million, representing an increase of \$62.6 Million, or 49%, compared to 2004. Net income for 2005 totaled \$31.7 Million (\$1.08 per diluted share), representing an increase of \$11.5 Million, or 57%, compared to 2004.

The increase in our operating results during 2005 primarily resulted from the introduction of additional capital equipment and enhanced market penetration by all of our divisions, coupled with a robust drilling and completions market throughout 2005.

Natural gas prices, and to a lesser extent oil prices, are the primary drivers of our activity levels. The AECO natural gas spot price averaged approximately \$8.69 per million cubic feet ("mcf") during 2005, compared to \$6.22 per mcf during 2004. West Texas Intermediate oil prices averaged over \$56.70 (U.S.) per barrel during 2005, up from \$43.45 (U.S.) per barrel during 2004. Countering positive commodity prices, Canadian exchange rates increased from an average of \$0.768 per U.S. dollar during 2004 to \$0.825 per U.S. dollar during 2005. The increase in the exchange rate, given that a substantial portion of our customer's revenues are denominated in U.S. dollars, has acted to reduce the Canadian dollar denominated cash flow of our customers in 2005 excluding commodity price changes.

Contract Drilling

Contract drilling revenue and operating margin (revenue less operating expenses) totaled \$101.0 Million and \$36.7 Million in 2005 versus \$65.1 Million and \$24.4 Million respectively in 2004, representing increases of 55% and 50%. These substantial increases were primarily the result of an increased fleet of drilling rigs. During 2005 Savanna averaged a deployed fleet of 25 rigs, versus an average of 15 rigs in 2004. The Company exited 2005 with 30 rigs in operation (2004 - 21 rigs). Utilization rates were adversely affected in 2005 as a result of extremely wet weather during the summer and fall. As a result, utilization dropped from 60.8% to 49.9% based on CAODC criteria. This drop occurred despite strong demand for our drilling equipment. This reduced rate of utilization also adversely affected operating margins, as discussed further below.

Capital assets directed at contract drilling at December 31, 2005 were \$151.2 Million, an increase of \$47.5 Million or 46% over 2004.

Operating margins for the contract drilling business decreased to 36.3% in 2005 from 37.5% in 2004, driven by reduced activity in the second and third quarters of 2005.

Well Servicing

Well servicing revenues and operating margin totaled \$31.8 Million and \$12.2 Million for 2005 versus \$22.4 Million and \$7.8 Million respectively in 2004, representing increases of 42% and 55%. The increase in revenues and operating earnings resulted from an overall increase in hourly rates of 17% for the well servicing fleet during 2005 versus 2004. The Company averaged a deployed fleet of 18 rigs in 2005, versus 16 in 2004, an increase of 13%. Well servicing hours during 2005 totaled 48,195 (2004 - 39,854) hours, an increase of 21% over 2004.

Operating margins in 2005 increased to 38.3% from 35.0% in 2004.

Wireline Services

Wireline services revenues and operating margin totaled \$58.8 Million and \$26.2 Million in 2005 compared to \$41.4 Million and \$16.9 Million, respectively, in 2004, representing increases of 42% and 55%. The increase in revenues and earnings primarily resulted from an increase in revenue per ticket. The wireline services division averaged 32 units (2004 -27) during the year and exited 2005 with 34 units (2004 - 30). Jobs during 2005 totaled 7,998 (2004 - 7,453), an increase of 7% over 2004. Pricing per job increased 32% to \$7,354 from \$5,559 last year. Operating margins during 2005 for the wireline services division were 44.6% compared to 40.8% during 2004.

Other Financial Information

Overall, operating margin percentages increased to 39.1% in 2005 from 38.0% in 2004. Operating margin percentages are calculated by dividing operating margins by sales and service revenue. As noted previously, the increase in our operating margin percentage is primarily due to increased capital asset levels, as well as increased utilization and pricing driven by a stronger market for our services in 2005 versus 2004.

General and administrative expenses increased by \$3.7 Million to \$10.3 Million, or 55% in 2005 compared to 2004, primarily due to an increase in stock-based compensation expense of \$1.6 Million as well as an increase in the infrastructure required to support our capital growth. As a percentage of revenues, general and administrative expenses increased to 5.3% from 5.1%.

Depreciation expense increased by \$3.0 Million to \$12.5 Million, or 31%, in 2005 compared to 2004 due to significant capital expenditures in our contract drilling division.

Interest expense increased by \$0.9 Million to \$2.5 Million during 2005 primarily due to increased borrowings under our revolving credit facility as well as an overall increase in interest rates. Capital expenditures decreased slightly from \$68.9 Million in 2004 to \$66.5 in 2005 and were funded by a combination of cash flow from operations and an increase in long-term debt.

Our effective income tax rate was 36% during 2005 compared to 35% for 2004, with the increase due to an increase in non-deductible stock-based compensation expense.

Quarterly Results

The quarterly results of Savanna are markedly affected by weather patterns throughout our operating area in Canada. Historically, the first quarter of the calendar year is very active followed by a much slower second quarter. Because the timing of the slower period is directly dependent on weather, the timing of the slow period could fall partially in the first or second quarter, or be completely contained within either of these quarters each year. As a result of this, the variation on the quarterly basis, particularly in the first and second quarters can be dramatic year over year independent of other demand factors.

With respect to the third and fourth quarters of the year, weather is also a factor, however, the demand for our services is generally much more consistent in these quarters and is much more dependent on the deployment of capital budgets of our customers. The factors affecting this aspect of our business have been discussed at length in other portions of this analysis. Outlined below are the results of our quarterly activities in 2005 and 2004.

Summary Quarterly Financial Information

(000's except per share data)	2005	2004	% Change
Revenue			
Q1	53,992	32,552	66%
Q2	25,736	20,637	25%
Q3	46,137	32,574	42%
Q4	65,749	43,250	52%
Net Earnings			
Q1	9,806	6,226	58%
Q2	1,107	1,021	8%
Q3	7,676	5,057	52%
Q4	13,138	7,941	65%
Net Earnings per share			
Q1	0.34	0.23	48%
Q2	0.04	0.04	0%
Q3	0.27	0.18	50%
Q4	0.45	0.28	61%
Net Earnings per share diluted			
Q1	0.33	0.22	50%
Q2	0.04	0.04	0%
Q3	0.26	0.17	53%
Q4	0.45	0.28	61%

Financial Condition and Liquidity

All of the market risks outlined above can affect the financial condition and liquidity of the Company. Savanna's ability to access its debt facilities is directly dependent, among other factors, on our working capital position and trailing cash flows. Additionally, the ability of the Company to raise capital through the issuance of equity would be restricted in the face of an existing or anticipated reduction in oilfield service demand.

While Savanna cannot anticipate all eventualities in this regard, the Company maintains a conservatively leveraged balance sheet, and makes every effort to ensure a balance between maximizing returns for our shareholders over both the short and long term activity levels in the oil and gas services business.

Working Capital and Cash Provided by Operations

For the year ended December 31, 2005, operating cash flows, before changes in non-working capital of \$57.4 Million (\$1.95 per diluted share) was \$18.4 Million, or 47% higher than the \$39.0 Million (\$1.36 per diluted share) for the 2004 year. The increase in cash flow results primarily from the increase in pre-tax income due to a larger capital equipment base and resulting in higher activity levels for 2005 compared to 2004. At December 31, 2005, the Company had working capital of \$12.1 Million compared to working capital of \$13.0 Million at December 31, 2004. The Company's bank indebtedness increased to \$4.6 Million at December 31, 2005 from \$1.9 Million in cash at December 31, 2004.

Investing Activities

For the year ended December 31, 2005, Savanna had net capital additions of \$66.5 Million, a decrease of \$2.4 Million over the net additions of \$68.9 Million in 2004. The majority of the 2005 capital expenditures relate to costs associated with the manufacture of drilling rigs for use in the contract drilling division. During the year, ten new drilling rigs and five wireline trucks were added to the Company's fleet of oilfield equipment. Prior to December 31, 2006, the Company anticipates taking delivery of fourteen new drilling rigs, two wireline units and four service rigs.

Financing Activities

During 2005, the Company repaid \$21.7 Million (2004 - \$26.1 Million) of its outstanding long term debt and capital leases. Excluding the \$8.6 Million current portion of long term debt and capital leases, at December 31, 2005 Savanna had long term debt outstanding, including capital leases, of \$43.2 Million (2004 - \$38.2 Million).

In December, 2004, the Company replaced its operating and term credit facilities with a \$75 Million committed revolver facility with a syndicate of banks. The facility is renewed every 365 days on June 30th at the banks' discretion, and reverts to a three year term loan with a four year amortization if not renewed.

In February, 2004, the Company issued 2 Million common shares at a price of \$9.00 per share for gross proceeds of \$18 Million.

Contractual Obligations

In the normal course of business the Company incurs contractual obligations, primarily related to short and long term indebtedness. The following table sets forth the Company's contractual obligations for the following items as at December 31, 2005.

(In Thousands)	Total	2006	2007	2008	2009	2010 and subsequent years
Long term debt obligations ⁽¹⁾	48,200	6,835	11,990	11,750	17,625	-
Capital lease obligations	3,601	1,637	1,267	636	61	-
Operating lease and equipment purchase obligations	20,447	18,577	750	616	299	205
Total Obligations	72,248	27,049	14,007	13,002	17,985	205

(1) Excludes capital lease obligations and assumes the revolving credit facility is not renewed in 2006.

For 2006 and the foreseeable future, the Company expects cash flow from operations and from its various sources of financing to be sufficient to meet its debt repayments and future obligations, and to fund anticipated capital expenditures.

Risks and Uncertainties

As outlined above, lower commodity prices have a direct impact on our customer's ability to generate cash flows, which in turn directly impacts the demand for our services. These factors are beyond the control of Savanna, and therefore represent significant uncertainty for the Company overall. Savanna has been very proactive in its approach to credit management and has specific policies and procedures to mitigate credit risk. In addition to market factors, governmental legislation in respect of environmental and safety matters, and unpredictable weather can also significantly impact the Company's demand for, and ability to supply, services.

In addition to active efforts to address its operational and market risks, Savanna carries what it believes to be adequate property and comprehensive public liability insurance to protect itself in the event of destruction or damage to its property or equipment and to limit exposure in the face of unforeseen incidents.

We are exposed to fluctuations in short-term interest rates from our floating-rate debt and, to a lesser extent, derivative instruments, as their market value is sensitive to interest rate fluctuations. We maintain a portion of our debt capacity in revolving, floating-rate bank facilities with the remainder issued in fixed-rate borrowings as a result of an interest rate swap on \$10 Million (2004 - \$10 Million) of the Company's credit facilities. This interest rate swap minimizes our exposure to interest rate fluctuations.

At December 31, 2005, approximately 26% (2004 - 31%) of long-term debt and obligations under capital leases were subject to fixed rates.

Recent Accounting Pronouncements

Impairment of long-lived assets

On January 1, 2004, the Company adopted the new accounting standards for impairment of long-lived assets, which establishes the standards for recognition, measurement and disclosure of the impairment of long-lived assets. The standards require that long-lived assets be tested for recoverability at least annually and whenever events or circumstances indicate that carrying value may not be recoverable. No impairment loss has been recognized in the statement of earnings.

Asset retirement obligations

On January 1, 2004, the Company adopted the new standard for accounting for asset retirement obligations, whereby the Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. The associated asset retirement costs before salvage values are capitalized as part of the carrying amount of the long-lived asset. The liability is accreted over the estimated time period until settlement of the obligation and the asset is amortized over the estimated useful life of the asset.

Previously, no provision for future removal and site restoration costs for the Company's capital assets had been recognized as the costs of restoration were expected to be offset by the salvage value of the assets. The estimated fair value of the asset retirement obligation for the Company's capital assets is nominal. Accordingly, no provision has been made for the asset retirement obligation.

Critical Accounting Estimates

The principle critical accounting estimates in respect of the Company relate to depreciation of capital assets, including asset and impairment write-downs, if any. All depreciation and amortization is carried out on the basis of the estimated useful lives of the related assets. Equipment under construction is not depreciated until it is put into use. Included in capital assets is equipment acquired under capital leases. All equipment is depreciated based on the straight-line method, utilizing either years, in the case of all non-drilling assets, or operating days, in the case of drilling equipment. All equipment is depreciated net of expected residual values of 10% - 20%.

Assessing the reasonableness of the estimated useful lives of properties requires judgment and is based on currently available information, including periodic depreciation studies conducted by the Company. Additionally, the Company canvasses its competitors to ensure it utilizes methodologies and rates consistent with the remainder of the sector in which Savanna operates. Changes in circumstances, such as technological advances, changes to the Company's business strategy, changes in the Company's capital strategy or changes in regulations may result in the actual useful lives differing from the Company's estimates.

A change in the remaining useful life of a group of assets, or their expected residual value, will affect the depreciation rate used to amortize the group of assets and thus affect depreciation expense as reported in the Company's results of operations. These changes are reported prospectively when they occur.

Disclosure Controls and Procedures

The CEO and CFO are responsible for establishing and maintaining disclosure controls and procedures for the Company. The disclosure controls and procedures have been designed, under the supervision of the CEO and CFO, to provide reasonable assurance that material information relating to Savanna or its subsidiaries is known to management in the period in which the annual filings are made. The Company's CEO and CFO periodically review the Company's disclosure controls and procedures for effectiveness and conducted an evaluation as at the end of the 2005 fiscal year. As of the end of the 2005 fiscal year the Company's CEO and CFO were satisfied that the Company's disclosure controls and procedures were effective in providing reasonable assurance that material information has been appropriately disclosed.

Outlook

Historically, demand for oilfield services has been closely correlated with actual and anticipated future oil and natural gas commodity prices. Increased levels of commodity pricing generally translate into increased cash flows for our customers, the oil and natural gas producers. In addition to improved cash flows, higher oil and natural gas prices provide incentive for our customers to take advantage of strong commodity prices and improved levels of cash flow by increasing production and adding to reserves. During 2005, this certainly was the case. The high commodity prices and related high activity levels have carried on into the early portion of 2006, and indications are that they will continue throughout the remainder of 2006 as well. While current pricing for both oil and natural gas is lower than during 2005 on average, it is still significantly higher than historical averages. Commodity prices and drilling activity are directly linked. Any sustained decrease in commodity prices could be expected to adversely affect service activity. However, any prolonged decrease in activity would correspondingly adversely affect supply. This would drive prices for the commodities higher and create increased activity to meet the supply shortfall.

Savanna currently operates solely within the Western Canadian Sedimentary Basin. As a result of this, despite high commodity prices and strong demand from our customers, weather, particularly during the second quarter of the calendar year, can significantly impact utilization of our services. Weather-related seasonality can detrimentally affect Savanna's ability to utilize its equipment despite pent-up demand from its customers.

Savanna currently anticipates financial results for 2006 to be improved over the results for the 2005 fiscal year due to a larger fleet of equipment throughout each of its three divisions coupled with an assumed demand for the Company's services consistent with the 2005 year.

Management's Report

All information presented in this Annual Report is the responsibility of the Company's management. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include amounts that are based on management's judgments and estimates as required. Management has ensured that financial information contained elsewhere in this Annual Report is consistent with the consolidated financial statements.

Management maintains internal control systems designed to provide reasonable assurance that assets are safeguarded, transactions are properly authorized, financial records are accurately maintained and financial statements are generated in a timely manner.

The Audit Committee of the Board of Directors, with all of its members being outside directors, has reviewed the financial statements with management and Deloitte & Touche LLP, the Company's external auditors. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.



Ken Mullen
President and
Chief Executive Officer

March 9, 2006



Darcy Draudson
Vice-President, Finance and
Chief Financial Officer

Auditors' Report

To the Shareholders of

Savanna Energy Services Corp.:

We have audited the consolidated balance sheets of Savanna Energy Services Corp. as at December 31, 2005 and 2004 and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
February 23, 2006

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants

Consolidated Statements of Earnings and Retained Earnings

Years Ended December 31, 2005 and 2004
(In thousands, except per share data)

	2005 \$	2004 \$
REVENUE		
Sales and services	191,614	129,013
EXPENSES		
Operating	116,619	79,997
General and administrative	10,251	6,597
Depreciation	12,513	9,552
	139,383	96,146
	52,231	32,867
Interest on long-term debt and capital leases	(2,495)	(1,591)
Interest and other income	32	86
EARNINGS BEFORE INCOME TAXES	49,768	31,362
INCOME TAXES (Note 8)		
Current	6,863	2,610
Future	11,178	8,507
	18,041	11,117
NET EARNINGS	31,727	20,245
RETAINED EARNINGS, BEGINNING OF YEAR	28,440	8,195
RETAINED EARNINGS, END OF YEAR	60,167	28,440
EARNINGS PER SHARE (Note 13)		
Basic	1.10	0.73
Diluted	1.08	0.71

Consolidated Balance Sheets

December 31, 2005 and 2004 (In thousands)	2005 \$	2004 \$
ASSETS		
CURRENT		
Cash	-	1,944
Accounts receivable	49,577	29,911
Inventories	4,719	3,569
Prepaid expenses and deposits	725	413
	55,021	35,837
Goodwill	4,075	4,075
Capital assets (Note 4)	217,911	164,935
Other assets, net of accumulated amortization of \$288 (2004 - \$197)	322	355
	277,329	205,202
LIABILITIES		
CURRENT		
Bank indebtedness (Note 6)	4,604	-
Accounts payable and accrued liabilities	25,779	18,433
Income taxes payable	3,953	2,290
Current portion of obligations under capital leases (Note 5)	1,754	1,144
Current portion of long-term debt (Note 6)	6,835	960
	42,925	22,827
Obligations under capital leases (Note 5)	1,847	1,366
Long-term debt (Note 6)	41,365	36,825
Future income taxes (Note 8)	25,906	14,727
	112,043	75,745
SHAREHOLDERS' EQUITY		
Share capital (Note 7)	103,049	100,697
Contributed surplus (Note 7)	2,070	320
Retained earnings	60,167	28,440
	165,286	129,457
	277,329	205,202

APPROVED BY THE BOARD



Dennis Nerland, Director



Ken Mullen, Director

Consolidated Statements of Cash Flows

Years Ended December 31, 2005 and 2004
(In thousands)

	2005 \$	2004 \$
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	31,727	20,245
Adjustments for:		
Depreciation	12,513	9,552
Amortization of deferred financing costs	91	136
Future income taxes	11,178	8,507
Non-cash compensation expense	1,915	485
Loss (gain) on disposal of capital assets	(18)	40
Operating cash flows, before changes in non-cash working capital	57,406	38,965
Changes in non-cash working capital (Note 14)	(14,285)	(5,843)
	43,121	33,122
FINANCING		
Deferred financing costs incurred	(2)	(290)
Shares issued on exercise of stock options (Note 7)	2,187	1,799
Shares issued on private placement (Note 7)	-	18,000
Share issue costs (Note 7)	-	(930)
Repayment of capital lease obligations	(1,763)	(1,592)
Issuance of long-term debt	30,375	45,625
Repayment of long-term debt	(19,960)	(24,460)
	10,837	38,152
INVESTING		
Proceeds on disposal of capital assets	1,048	806
Changes in working capital related to investing activities	2,166	1,200
Purchase of other assets	(56)	(26)
Purchase of capital assets	(63,664)	(67,260)
	(60,506)	(65,280)
NET CHANGE	(6,548)	5,994
CASH (BANK INDEBTEDNESS), BEGINNING OF YEAR	1,944	(4,050)
CASH (BANK INDEBTEDNESS), END OF YEAR	(4,604)	1,944
SUPPLEMENTARY CASH INFORMATION (Note 10)		

Notes to the Consolidated Financial Statements

Years Ended December 31, 2005 and 2004
(In thousands, except per share amounts)

1. DESCRIPTION OF BUSINESS

Savanna Energy Services Corp. (the "Company") was incorporated under the Alberta Business Corporations Act on March 22, 2001, to provide a variety of services in the oil and natural gas industry. The Company's business segments are discussed in Note 11.

2. BASIS OF PRESENTATION

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, and include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

3. SIGNIFICANT ACCOUNTING POLICIES

Cash and cash equivalents

Cash equivalents include deposits with a term to maturity less than 90 days.

Inventories

Inventories of parts and operating supplies are valued at the lower of cost, determined on a weighted average basis, and net realizable value.

Capital assets

Capital assets are recorded at cost and are depreciated at the following rates:

Buildings	20 years straight line
Field equipment - non-drilling	10 to 15 years straight line
Field equipment - drilling	3600 to 4125 operating days
Furniture and office equipment	3 to 5 years straight line
Equipment under capital leases	3 to 5 years straight line

Field equipment is depreciated to expected residual values of 10% to 20% of its original cost. Equipment under construction is not depreciated until available for use.

Deferred financing costs

Deferred financing costs are amortized on a straight-line basis over the life of the related long-term debt.

Impairment of long-lived assets

Long-lived assets are tested for recoverability at least annually at year end, or whenever events or circumstances indicate that carrying value may not be recoverable. Assets are tested internally and/or by independent third parties for recoverability by examining expected discounted future cash flows and benefits to ensure that the fair value is greater than, or equal to, the carrying value.

Asset retirement obligations

The Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. The associated asset retirement costs before salvage values are capitalized as part of the carrying amount of the capital asset. The liability is accreted over the estimated time period until settlement of the obligation and the asset is amortized over the estimated useful life of the asset.

As at December 31, 2005, the estimated fair value of the asset retirement obligation for the Company's capital assets is nominal. Accordingly, no provision has been made for any asset retirement obligation.

Future income taxes

The Company has adopted the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are recorded based on temporary differences, which are the differences between the carrying amount of an asset and liability in the consolidated balance sheet and its tax basis. The Company's future tax balances have been reflected at the substantively enacted tax

rates which are expected to apply when the temporary differences between the accounting and tax balances of the Company's assets and liabilities are reversed.

Earnings per share

Earnings per share are calculated using the weighted average number of shares outstanding. Diluted earnings per share are calculated using the treasury stock method where the deemed proceeds of the exercise of options is considered to be used to reacquire shares at an average share price.

Stock-based compensation

The Company has a stock option plan as described in Note 7. The Company follows the fair value based method of accounting, using the Black-Scholes option pricing model, for options granted subsequent to January 1, 2002, whereby, compensation expense is recognized for the stock options on the date of granting, and amortized over the options' vesting period.

Goodwill

Goodwill is recorded at cost and is not amortized. The recorded amount of goodwill is tested for impairment, based on expected future cash flows of the reporting segment to which the goodwill is attributable, at least annually at year end, or whenever events or circumstances indicate a possible impairment, to ensure that the fair value is greater than, or equal to, book value. Any impairment is charged to income in the period in which it is determined.

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The most significant of these estimates are related to the depreciation period for capital assets, the recoverability of capital assets and goodwill, the provision of doubtful accounts receivable, and estimates in future income taxes. Actual results could differ significantly from these estimates.

Revenue recognition

Revenue is recognized at the time the product is delivered or service is performed on a daily, hourly or job basis.

Financial instruments

The Company enters into interest rate swaps to manage the impact of floating interest rates. Hedge accounting is used when there is a high degree of correlation between changes in cash flows of the swap instrument and the cash flows relating to the interest on the long-term debt. The Company assesses, both at inception of the hedge and on a quarterly basis, the effectiveness of the hedging relationship.

Interest rate swaps that have been designated as hedges are not recognized in the consolidated balance sheet. Gains or losses on these contracts, including realized gains and losses on hedging swap agreements settled prior to maturity, are recognized when the related hedged transaction is recognized. If effectiveness ceases, the Company discontinues hedge accounting and subsequent changes in market value of the interest rate swap, are recognized in the period of change.

4. CAPITAL ASSETS

	2005		
	Cost	Accumulated	Net Book
	\$	Depreciation	Value
	\$	\$	\$
Land	1,791	-	1,791
Buildings	5,717	499	5,218
Field equipment	211,131	25,362	185,769
Equipment under construction	20,278	-	20,278
Furniture and office equipment	1,334	719	615
Equipment under capital leases	6,224	1,984	4,240
	246,475	28,564	217,911

	2004		
	Cost	Accumulated Depreciation	Net Book Value
	\$	\$	\$
Land	893	-	893
Buildings	3,599	263	3,336
Field equipment	164,154	14,663	149,491
Equipment under construction	7,600	-	7,600
Furniture and office equipment	1,006	443	563
Equipment under capital leases	4,503	1,451	3,052
	181,755	16,820	164,935

5. OBLIGATIONS UNDER CAPITAL LEASES

Minimum lease payments under the capital leases are as follows:

	2005	2004
	\$	\$
Year ending December 31, 2005	-	1,191
2006	1,945	1,055
2007	1,363	465
2008	669	16
2009	79	-
Total minimum lease payments	4,056	2,727
Less amount representing future interest at annual rates between 6.3% and 9.5%	455	217
Balance of obligations	3,601	2,510
Less current portion	1,754	1,144
	1,847	1,366

6. LONG-TERM DEBT

	2005	2004
	\$	\$
Term loan, bearing interest at the lender's floating base rate (December 31, 2005 - 3.842 % , 2004 - 3.057%) plus 2.75% per annum, repayable in monthly principal payments of \$80 plus interest and is secured by a first charge on specific field equipment and a second charge on all other assets of a subsidiary (described below)	1,200	2,160
Revolving credit facility	47,000	35,625
	48,200	37,785
Less current portion	6,835	960
	41,365	36,825

During 2004, the Company repaid its operating and term credit facilities with a \$70,000 committed revolver facility and a \$5,000 swingline facility, of which \$4,604 (2004 - Nil) was drawn at December 31, 2005, with a syndicate of banks that is renewed every 365 days at the bank's discretion and reverts to a three year term loan with a four year amortization if it is not renewed on the annual renewal date (June 30th). Borrowings under the facility may be made by way of prime rate based advances, bankers'

acceptances, letters of credit, US based rate or LIBOR advances. The facility bears interest at the bank's prime rate to prime plus 0.75%, bankers' acceptance, letter of credit, or LIBOR rate plus a 1.5% to 2.25% stamping fee which is dependant on certain financial ratios of the Company. A commitment fee of 0.2% to 0.35% per annum is paid on the unused portion of the facility. The facility is secured by a general security agreement over all the present and future property of the Company and its subsidiaries, and a priority agreement with a commercial lender giving the banks priority on all assets of the Company and all its subsidiaries with the exception of Great Plains Well Servicing Corp.

Concurrent with securing the committed revolver facility, the Company fixed the interest rate on \$10,000 of the facility at 4.27% plus a stamping fee for a four year period ending on December 16, 2008. As of December 31, 2005, the unrecognized loss on this interest rate swap is approximately \$42.

Principal repayments required on the term loan over the next two years are as follows:

	\$
2006	960
2007	240
	1,200

Potential principal repayments required on the revolving credit facility over the next four years are as follows:

	\$
2006	5,875
2007	11,750
2008	11,750
2009	17,625
	47,000

7. SHARE CAPITAL

	Number of Shares	Amount \$
Authorized		
Unlimited number of common shares		
Unlimited number of 1st preferred shares		
Unlimited number of 2nd preferred shares		
Issued		
Common shares		
Balance December 31, 2003	25,743	81,343
Stock options exercised	600	1,799
Demand promissory notes paid	2	5
Issued under employee bonus plan	55	165
Issued on private placement	2,000	18,000
Share issue costs (net of tax of \$315)	-	(615)
Balance December 31, 2004	28,400	100,697
Stock options exercised	632	2,187
Contributed surplus related to stock options exercised	-	165
Balance December 31, 2005	29,032	103,049

Reserved for issue

The Company has 2,695 (2004 - 2,253) common shares reserved for issue upon conversion of stock options.

Stock option plan

The Company has a stock option plan for the purpose of developing the interest of directors, officers, employees and consultants of the Company and its subsidiaries in the growth and development of the Company by providing them with the opportunity, through share options, to acquire an increased proprietary interest in the Company. At December 31, 2005, 1,659 (2004 - 1,757) options were outstanding at exercise prices between \$3.00 and \$26.90 per share. The options expire from August 21, 2006 to December 5, 2010 and vest in equal amounts over three years.

	2005		2004	
	Share Options	Weighted Average Exercise Price (Per Share) \$	Share Options	Weighted Average Exercise Price (Per Share) \$
Outstanding, beginning of period	1,757	5.28	1,950	3.00
Granted	545	22.72	407	12.85
Exercised	(632)	3.46	(600)	3.00
Cancelled	(11)	10.98	-	-
Outstanding, end of period	1,659	11.67	1,757	5.28

The following table summarizes information about stock options outstanding at December 31, 2005.

	2005			
	Exercise Price (Per Share)	Number of Options Outstanding	Weighted Average Contractual Life (years)	Number of Options Exercisable
	\$ 3.00	752	0.9	741
	\$10.25	155	3.4	31
	\$12.25	17	3.6	4
	\$15.35	190	3.9	61
	\$17.55	222	4.4	-
	\$19.27	25	4.6	-
	\$25.65	8	4.7	-
	\$26.90	290	4.9	-
		1,659		837

Compensation expense for stock options is recognized using the fair value when the stock options are granted, and are amortized over the option's vesting period. During the year ended December 31, 2005, \$1,915 (2004 - \$320) in compensation expense has been recognized in the consolidated statement of earnings to reflect the fair value of 545 (2004 - 407) stock options granted during the year. The per share weighted average fair value of stock options granted during the year was \$8.28 (2004 - \$5.31) at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 4.73%, expected life of four years, no annual dividends paid, and expected volatility of 39%.

Had the Company determined compensation costs based on the fair value method at the date of grant for stock options granted prior to 2003, net earnings would have decreased by \$11 (2004 - \$31) and earnings per share (basic and diluted) would not have changed for the years ended December 31, 2005 and 2004. These proforma earnings reflect compensation cost amortized over the option's vesting period.

Changes in contributed surplus are as follows:

	2005 \$	2004 \$
Balance, beginning of year	320	-
Compensation expense on stock options	1,915	320
Reclassified to share capital when stock options exercised	(165)	-
Balance, end of year	2,070	320

Employee bonus plan

The Company has an employee bonus plan for field employees which allows the Company to pay out bonuses in either cash or, for periods prior to December 31, 2003, shares, at its discretion. The terms of the bonus plan require certain performance criteria to be met. In 2003, the Company issued 191 common shares at \$3.00 per share, totalling \$572. Of the \$572 total, \$339 was accrued and expensed as compensation in 2002, \$68 was accrued and expensed as compensation in 2003, and the remaining \$165 was expensed as compensation in 2004 to reflect the periods in which the performance criteria was met. The shares were issued and held by the Company and distributed to the employees when the performance criteria were met.

8. INCOME TAXES

The provision for income taxes differs from the result, which would be obtained by applying the combined federal and provincial income tax rate of 33.6% (2004 - 33.9%) to the earnings before income taxes. This difference results from the following items:

	2005 \$	2004 \$
Earnings before income taxes	49,768	31,362
Computed income tax expense at statutory rate	16,732	10,622
Increase (decrease) resulting from:		
Large corporation tax	464	299
Non-deductible expenses	837	469
Permanent differences relating to dispositions of capital assets	(4)	15
Reduction due to substantively enacted tax rates	-	(258)
Other	12	(30)
	18,041	11,117
Represented by:		
Current	6,863	2,610
Future	11,178	8,507
	18,041	11,117

The Company has non-capital losses available for carryforward for tax purposes totalling \$115 (2004 - \$4,896) which may be applied to reduce future taxable income. These losses expire in 2009. The tax effect of these losses has been recognized as part of the future income tax balance on the consolidated balance sheet as follows:

	2005 \$	2004 \$
Future income tax assets		
Non-capital losses available for carryforward	39	1,646
Scientific research and experimental development expenditures and investment tax credits	192	279
Share issue costs	436	769
Other	8	8
	675	2,702
Future income tax liabilities		
Capital assets	26,570	17,425
Other	11	4
	26,581	17,429
Net future income tax liability	25,906	14,727

9. COMMITMENTS

The Company has commitments for office and shop premises, operating vehicles and equipment leases and purchases. Payments required in each of the next five years are as follows:

	\$
2006	18,577
2007	750
2008	616
2009	299
2010	205

10. SUPPLEMENTARY CASH INFORMATION

	2005 \$	2004 \$
Cash interest paid	2,433	1,420
Cash interest received	14	6
Cash income taxes paid	5,204	534
Cash income taxes received	6	70

Significant non-cash transactions for the year ended December 31, 2005 include capital assets acquired under capital leases totalling \$2,855 (2004 - \$1,640).

11. SEGMENTED INFORMATION

The Company's reportable operating segments, as determined by management, are strategic operating units that offer different products and services, and typically do not transact with one another. The Company has several reportable operating segments: corporate, wireline, service rigs, and drilling. All operating segments are substantially in one geographic segment, the western Canadian sedimentary basin.

The *corporate* segment provides management and administrative services to all its subsidiaries and their respective operations. Corporate segment assets include real estate used by field operations including shop premises.

The *wireline* segment provides cased hole electric line and slick line services to the oil and gas industry.

The *service rig* segment provides well servicing services to the oil and gas industry.

The *drilling* segment provides primarily coiled tubing drilling services to the oil and gas industry.

2005					
	Corporate \$	Wireline \$	Service Rigs \$	Drilling \$	Total \$
Revenue	-	58,820	31,789	101,005	191,614
Expenses					
Operating	79	32,593	19,629	64,318	116,619
Operating margin	(79)	26,227	12,160	36,687	74,995
General and administrative					10,251
Depreciation					12,513
Earnings from operations					52,231
Goodwill	-	1,398	2,677	-	4,075
Capital assets	7,381	24,790	34,529	151,211	217,911
Capital expenditures	3,295	6,291	2,971	53,968	66,525
2004					
	Corporate \$	Wireline \$	Service Rigs \$	Drilling \$	Total \$
Revenue	-	41,434	22,442	65,137	129,013
Expenses					
Operating	158	24,542	14,594	40,703	79,997
Operating margin	(158)	16,892	7,848	24,434	49,016
General and administrative					6,597
Depreciation					9,552
Earnings from operations					32,867
Goodwill	-	1,398	2,677	-	4,075
Capital assets	4,528	22,282	34,368	103,757	164,935
Capital expenditures	646	6,308	3,436	58,477	68,867

12. FINANCIAL INSTRUMENTS

Fair value

The Company's financial instruments recognized on the consolidated balance sheet include cash, bank indebtedness, accounts receivable, and accounts payable and accrued liabilities. The fair values of these financial instruments approximate their carrying amounts due to their short-term nature. Financial instruments also include long-term debt and obligations under capital leases. The fair values of these financial instruments are not significantly different than their carrying amounts as the stated interest rates reflect the current borrowing rates available to the Company.

Interest rate risk

The Company is exposed to interest rate risk on debt instruments to the extent of changes in the prime interest rate. Approximately 26% (2004 - 31%) of long-term debt and obligations under capital leases are subject to fixed interest rates with terms greater than one year.

Credit risk

The Company is exposed to credit risk to the extent that its customers in the oil and gas industry experience financial difficulty and would be unable to meet their obligations. Two customers comprised 33% (2004 - 30%) of revenue for the year ended December 31, 2005 and 27% (2004 - 17%) of accounts receivable at December 31, 2005.

13. PER SHARE AMOUNTS

Earnings per share have been calculated using the weighted average number of common shares outstanding during the year of 28,749 (2004 - 27,781). Diluted earnings per share in these consolidated financial statements have been calculated using the diluted weighted average number of common shares outstanding during the year of 29,491 (2004 - 28,689). We have excluded 298 options (2004 - Nil) from the diluted weighted average number of common shares outstanding during the year because their exercise price was greater than the annual average common share market price.

	2005 Number of Shares	2004 Number of Shares
Basic weighted average shares outstanding	28,749	27,781
Effect of dilutive securities:		
Options (Note 7)	742	1,088
Diluted weighted average shares outstanding	29,491	28,869

14. CHANGES IN NON-CASH WORKING CAPITAL

	2005 \$	2004 \$
Accounts receivable	(19,666)	(12,200)
Inventories	(1,150)	(1,327)
Prepaid expenses and deposits	(312)	24
Accounts payable and accrued liabilities	5,180	5,480
Income taxes payable	1,663	2,180
	(14,285)	(5,843)

15. CONTINGENCY

At December 31, 2005 the Company was subject to legal claims with respect to the Company's patents. Although the outcome of this matter is not determinable at this time, the Company believes the claims will not have any material adverse effect on the Company's financial position or results of its operations.

Corporate Information

Directors

Chris Nixon
Chairman
Calgary, Alberta

John Hooks
Calgary, Alberta

Steve Johnson
Calgary, Alberta

Ken Mullen
Calgary, Alberta

Dennis Nerland
Calgary, Alberta

Management

Ken Mullen
President and Chief Executive
Officer

George Chow
Executive Vice-President, Corporate

Darcy Draudson
Vice-President, Finance and
Chief Financial Officer

Chris Oddy
Vice-President, Operations and
Chief Operating Officer

Lori Connell
Corporate Secretary

Banker

TD Canada Trust
Calgary, Alberta

Auditors

Deloitte & Touche LLP
Chartered Accountants
Calgary, Alberta

Legal Counsel

Stikeman Elliott LLP
Barristers & Solicitors
Calgary, Alberta

Operating Management

Great Plains Well Servicing Corp.
Gordon Moug - Vice-President
Brad Kingston - Operations Manager
Jason Milroy - Sales Manager

Ultraline Services Corporation
Les Owens - Vice-President
Rick Zahariuk - Sales Manager

Trailblazer Drilling Corp.
Gene Carriere - Vice-President
Don Goldade - Manager, Field Operations
Brad Carlson - Sales Manager

Technical Services
Brian Nodwell - Chief Information Officer

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